Facebook IPO case study

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Abstract

In this paper the main aim is to describe the process through which Facebook Inc. went public on May 18, 2012, raising $ bn 16, $ bn 18.4 including the greenshoe option. We start investigating what is an initial public offer, describing the six stages: syndicate selection, preparation, Analyst presentation and research, investor education, roadshow and book building, pricing allocation and closing. Subsequently, we analyse the IPO of Facebook, describing first what is the business of the company and then the reasons that brought Facebook public. Then, after the study of each phase of the IPO, we will examine the first and subsequent day of trading, and the problems created by NASDAQ and Morgan Stanley.

Summary

Introduction

The paper is focused on one of the biggest initial public offering (IPO) in both technology and internet sector. Facebook Inc., the world-famous American company, went public on May 18th 2012, raising $ 16 bn, $ 18.4 bn including the greenshoe option.

The most famous social network, whose "mission is to make world more open and connected" through a website and a mobile app where people can connect, share and communicate with friends.

The stock market launch went wrong with respect to what predicted: it was characterized by trading issues and questionable information-sharing accusations, the share value struggled to stay above the IPO level since the very first day and took an entire year to reach the level back. Many experts named Facebook IPO even a "fiasco".

Nevertheless, we would like, in this short group work, to analyse and describe, in all its aspects, one of the three biggest IPO in US history: it became second only to the VISA IPO thanks to the exercise of the greenshoe option, overtaking the General Motors' one.

Facebook IPO is also among the top ten of the biggest initial public offering worldwide; it is still nowadays the greatest in the tech sector, and it set also a new record for trading volume for an IPO: 420 million shares.

What is an IPO?

We refer to IPO as the first offer of shares of a private company to public. This tool leads to the listing of a given quantity of shares called floating stocks on a regulated market, such as NASDAQ or London stock exchange. This process is made of 6 steps:

1 Syndicate selection: the company chooses the bank/s which will compose the syndicate, on the base of bank distribution strengths, commitment of the resource sector of the bank and relationship between issuer and managing directors of the bank. The syndicate is composed of global coordinators, banks that lead the process and are responsible for the deal, joint bookrunners, banks that participate in marketing and book building and finally, lead managers, banks that provide only research coverage.

2 Preparation: a process of due diligence is conducted such that the disclosure of all the information is accurate and mistakes or omissions are avoided. The syndicate of banks together with the legal advisors start analysing all the useful information that should be included in prospectus. The business and financial data are covered by investment banks and, on the other hand, the legal aspect is examined by the legal counsel.

The prospectus is a legal and a marketing document that begins with a summary, a brief description of the business of the company and some trends of the last three or five years. It contains also the risk profile of the business, the industry data with a business accurate description, the financial position, the financial data and long form working capital, the dividend policy, the use of proceeds, the principal shareholders and selling shareholders, the principal related party transactions, the management and employees, and taxation. Summarizing, the prospectus must disclose all the relevant information that an investor should be aware before investing in that company.

Once it is formulated, the document is written, approved from the competent authority and then published. The regulatory review process can change from country to country – for example in Europe, as directive 2003/71/ec of the European parliament and of the Council of 4 November 2003 dictates, the prospectus must disclose all the information that could affect the price. The directive also describes the sanctions in case of lack of compliance and the supervisory approval process. It states that the prospectus has to be approved from the home member state securities and exchange commission, such as Consob (*Commissione Nazionale per le Società e la Borsa*) in Italy, Amf (*Autorité des marchés financiers*) in France or Fca (Financial Conduct Authority*)* in the United Kingdom. The issuer has the right to choose between the national and European supervisor ESMA (European Security and Markets Authority) only for some class securities, for example when the prospectus concerns a debt issue.

3 Analyst presentation and research: analysts of the investment banks prepare and publish a report that concerns all the information available also in the prospectus and based on the syndicate valuation of the company. The report usually concerns an industry overview with a company description specifying all the relevant financial data. Together with the report, the analysts prepare also a presentation that is oriented to the target investors' audience and it aims to let them become familiar with the company. What is important from the legal point of view is that the aforementioned document only gives information about the equity history, the growth story, the market presence, the strategy, the capital structure and the dividend policy. This means that it is not a legal document like the prospectus, but it is purely an investor education document.

4 Investor education: the syndicate analysts go on the road to market their report. During this period that in general lasts 2 weeks, analysts educate around 150 investors. The main goals comprehend the identification of the key investors, the initial reaction of the market and the investors' concerns. At the end of this phase, a price range will be established.

5 Roadshow and book building: the roadshow is a series of meetings with potential investors that lasts two weeks, the meeting can be a one to one or a group meeting. It is organised by the syndicate banks together with the management of the company, during the roadshow the banks "open" the book and start collecting orders.

6 Pricing, allocation and closing: once the book is closed, bookrunners can analyse the strength of demand, and the probability of aftermarket buying/selling, so it is obvious that the syndicate suggests a price that is willing to facilitate a favourable aftermarket performance. Same reasoning for allocation, where banks' proposal is based on the quality of the investor, on the size of the order and on the history of long-term holding of the investor. At this point, the IPO is closed and the shares of the company, by now listed, are publicly traded on the secondary market.

What is Facebook?

Almost everyone worldwide know what Facebook is and use it. Facebook was launched as a website in February 2004 by Mark Zuckerberg together with fellow Harvard college roommates and students, the aim was to connect Harvard students, then the aim became to connect students in American universities, finally people all around the world. The slogan states "Facebook is a social utility that connects you with the people around you".

Why did Facebook go public?

Marck Zuckerberg tried to keep Facebook private as long as he could: since he found the company in 2004, he never spoke about going public.

On 2/1 2012 Facebook submitted its S-1 form to the Security and Exchange Commission. The S-1 form is the file required by the competent authority cited above to a not listed company to prepare an IPO.

Many press articles discussed about the reasons behind this unexpected choice, but the real truth was only one: the main motive was an antiquated SEC rule from 1964.

This rule states that a company with more than 500 shareholders must adhere to financial disclosure that are identical to the ones provided to a stock exchange listed company, and adhere to them without going public was clearly not practical for a big company as Facebook was.

Facebook, knowing this rule, tried to avoid the problem as much as it could: for example, in 2011 it raised $450 million from Goldman Sachs, but asked to the financial corporation to structure the deal in a particular way that counts all the new shareholders as only one.

Facebook overcame the boundary of 500 shareholders due to the sale of shares by many early investors in private markets thanks to the observed incredible growth in the company during the years that made Facebook more and more required.

Other two reasons, that lead the owner and CEO Mark Zuckerberg to list publicly Facebook, were the possibility to obtain a highly liquid market for the investor, that instead were selling on private markets; and the possibility to obtain a currency with which to make acquisition.

Finally, Zuckerberg itself found his own interest in listing Facebook from the fact that he could sell many stocks without voting rights: he would maintain the control while investors would provide money without forcing him to take certain decisions, even from a legal side.

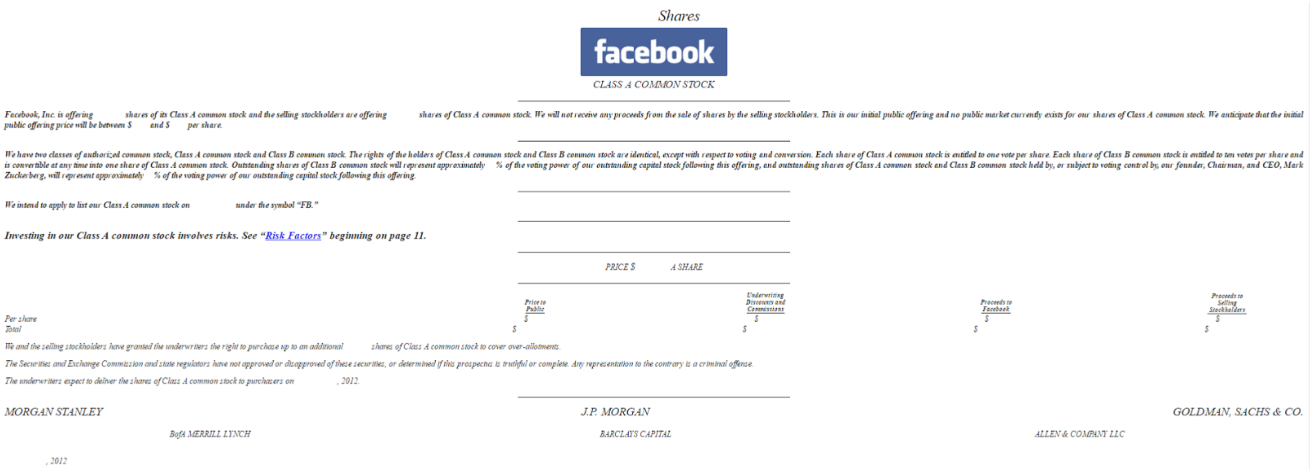
Facebook IPO

Syndicate

The world's largest social network was going to become public, it was supposed to be one of the biggest IPO of the United States, so this caused a competition in Wall Street, above all between Goldman Sachs Group Inc. and Morgan Stanley. For the past couple of decades, the two investment banks have ruled the tech IPO business, with one of the firms serving as lead manager on most of the hottest deals. This dispute between the top banks was a good signal, since if a company goes public without at least one of these two advisors this means that the company is not “good enough” for them.

As the image below shows, in the end, Facebook chose Morgan Stanley as company’s primary banker and J.P. Morgan and Goldman Sachs as the other lead banks. Moreover, below the aforementioned three banks, there are the co-managers, Bank of America Merrill Lynch, Barclays Capital and Allen & Company LLC.

In the prospectus, there will be a section in which are specified the number of shares underwitted by each bank.



Shares

CLASS A COMMON STOCK

Facebook, Inc. is offering shares of its Class A common stock and the selling stockholders are offering shares of Class A common stock. We will not receive any proceeds from the sale of shares by the selling stockholders. This is our initial public offering and no public market currently exists for our shares of Class A common stock. We anticipate that the initial public offering price will be between $ and $ per share.

We have two classes of authorized common stock, Class A common stock and Class B common stock. The rights of the holders of Class A common stock and Class B common stock are identical, except with respect to voting and conversion. Each share of Class A common stock is entitled to one vote per share. Each share of Class B common stock is entitled to ten votes per share and is convertible at any time into one share of Class A common stock. Outstanding shares of Class B common stock will represent approximately % of the voting power of our outstanding capital stock following this offering, and outstanding shares of Class A common stock and Class B common stock held by, or subject to voting control by, our founder, Chairman, and CEO, Mark Zuckerberg, will represent approximately % of the voting power of our outstanding capital stock following this offering.

We intend to apply to list our Class A common stock on under the symbol "FB."

Investing in our Class A common stock involves risks. See "Risk Factors" beginning on page 11.

PRICE $ A SHARE

	Price to Public	Underwriting Discounts and Commissions	Proceeds to Facebook	Proceeds to Selling Stockholders
Per share	$	$	$	$
Total	$	$	$	$

We and the selling stockholders have granted the underwriters the right to purchase up to an additional shares of Class A common stock to cover over-allotments.

The Securities and Exchange Commission and state regulators have not approved or disapproved of these securities, or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The underwriters expect to deliver the shares of Class A common stock to purchasers on , 2012.

MORGAN STANLEY J.P. MORGAN GOLDMAN, SACHS & CO.

BofA MERRILL LYNCH BARCLAYS CAPITAL ALLEN & COMPANY LLC

, 2012

Preparation

The preparation of the IPO includes the prospectus, edit by the syndicate and the legal advisors. In the case of Facebook, the company is based in Menlo Park, California, so it is subject to the United States law about the prospectus. In this country, the document needed by a company that is planning to go public is the *Form S-1*, that, as the European prospectus, must contain all the price sensitive information and helps investors in the investment decision.

It starts with the summary that contains a recap of all the information contained in the prospectus. Subsequently, there is a description of how Facebook can create value for users through the connection between them and their friends and through the possibility of expression of feelings and personal experience, but always controlling what they share with privacy settings. Moreover, Facebook is a "safe place" since "authentic identity is core to the Facebook experience" and Facebook "terms of service require you to use your real name and we encourage you to be your true self online".

Another important aspect is the use of proceeds that are divided in three pillars: acquisitions of complementary businesses, technologies or other assets, paying a portion of the anticipated tax, investments in investment-grade, interest-bearing securities such as money market funds, certificates of deposit, or direct or guaranteed obligations of the U.S. government, or hold as cash.

Furthermore, in the dividend policy is specified that the company has never paid dividend, and any future earnings will not be distributed and will be used in the operation of Facebook business.

The analysis of the industry is quite important since they estimated about two billion global internet users, and they also affirm that their aim is to reach all of them. Facebook achieved various levels of penetration in different countries, for example 60% in UK and 0% in China due to restricted access, and they affirm that there will be investment to increase the number of users. Moreover, the worldwide internet users are increasing and this represent a favourable trend for Facebook, but the future of the company also depends from the use of mobile devices in emerging market.

The executive officers and directors are listed in the following table:

Names	Position
Mark Zucherberg	Chairman and CEO
Sheryl K. Sandberg	Chief Operating Officer
David A. Ebersman	Chief Financial Officer
David B. Fischer	Vice President, Marketing and Business Partnerships
Mike Schroepfer	Vice president of Engineering
Theodore W. Ullyot	Vice President, General Counsel, and Secretary
Marc L. Andreessen	Director
Erskine B. Bowles	Director
James W. Breyer	Director
Donald E. Graham	Director
Reed Hastings	Director
Peter A. Thiel	Director

There is also a letter of the CEO in which he explains that Facebook was not created with the intent to build a company but just to connect people around the world, as he says “we think it’s important that everyone who invests in Facebook understands what this mission means to us, how we make decisions and why we do the things we do”. He outlines how the primary goal of the company is not to build services to make money, but to make money to create better services.

Roadshow

On May 1, 2012, Reuters announce that the roadshow of Facebook would start on May 7, 2012 and that Mark Zuckerberg would be involved in the process. As we said before, the roadshow is essentially a meeting in which the shares are sold through marketing, so could Facebook, a high technology and innovative social network company, do a conventional roadshow? Of course, not. Mark Zuckerberg with his managers recorded a video[1] in which they explain what

[1] https://www.youtube.com/watch?v=TyF2UAaMe_E

Facebook is and the reason why Facebook could become an extremely valuable company, so the reasons to invest in that IPO.

They underlined some important aspects of the mission such as the aim to connect the world and so a top priority is to increase the number of people using the social network, they also showed that this is a jet existing trend as the Facebook monthly active users (MAUs) had a growth of 69% from 2009 to 2010 and a growth of 39% from 2010 to 2011. The chief financial officer David Ebersman described the source of revenues, i.e. advertising, always the largest part, and payments and other fees, showing also in this case an increasing trend, from $m 777 in 2009 to $m 3,711 in 2011. Another aspect to consider is the capital expenditures as the network needs a large computer infrastructure to deliver Facebook rapidly and reliably.

Ebersman concluded saying that what matters is that Facebook has been successful for 8 years before IPO, prioritising the experience of the users and thanks to the long vision about how the web would evolve. Facebook has the opportunity to build a business that is innovative and valuable ten years from now and beyond. Through a strong and focused culture it is possible to build a company that is sustainably successful.

Valuation and price targets

Facebook analysts thought to a value around $30 for the initial price. But in the days before the IPO, the demand was high: many people, observing the IPOs of other internet companies such as Google or Linkedin, were seriously interested in gaining through this relatively new investment sector, so at the end the price for the IPO was set at the highest level of the range found during the roadshow, $38.

The first day public and the following days

On Friday May 18, 2012, the U.S. stock market started trading as usual at 9.30 a.m. IPOs listed on NASDAQ usually are traded at least one hour later, and that day indeed NASDAQ informed investors that the Facebook IPO trading would start at 11.

But at 11, no trading happened. In the next 30 minutes, there was only confusion of investors, and consequently jitters, until, finally, NASDAQ staff announced that, due to several technical problems that caused the delay, Facebook shares would be traded in two minutes.

Finally, at 11.30 a.m., eastern time, Facebook shares started to be traded with the ticker FB at the chosen price $38. More than 80 million shares change hands in less than 30 seconds. The stock raised immediately its value up to $42.

Despite of the initial hit, the first day saw the value struggling to stay above the IPO price. At 4 p.m., the closing bell, NASDAQ closed the selling of Facebook shares at $38.23, only 0.6 percent more than the opening price.

As mentioned before, the first day was characterized by technical problems. Firstly, many traders complained all day long about their orders to not be completed. Secondly, other investors denounced higher price than the one agreed for their transactions. In the afternoon, traders asked NASDAQ to delete or suspend Facebook transactions due to these technical problems but nothing was done by the stock exchange.

These technical problems, together with the help of underwriters, that were forced to buy back shares, save the first day of transactions preventing the price from falling down.

This buy back is the exercise of the so-called “Greenshoe Option”. It gives the rights to the issuer of selling more shares, maximum 15 percent more, than the number already planned. This option is used in two opposite situations: if the demand is higher than the expected or if the price is lower than the target price of the IPO, and the issuer want to stabilize this price. This last case was actually the Facebook case.

On the following day of trading, Monday May 21, 2012, NASDAQ OMX Group, the company who runs the index that listed Facebook shares, published a press release where it admitted his fault for some technical problems. But during the day mistakes and errors continued and at the closing bell the price was fallen to $34.03, of the 11 percent with respect to the IPO price.

On Tuesday May 21, 2012, Zuckerberg itself sold more than 30 million Facebook shares, cashing in and saving $174 million; at the same time, the Facebook director Peter Thiel, who own shares too, did the same. Since in an IPO is always a good sign that a key person like the CEO of a company keeps his money into his business, this sale operated by the Facebook owner and CEO made the investors sceptic even more.

At the close of the trading on NASDAQ, the price of the single Facebook share was fallen to $31, 18 percent less than the IPO price.

What follows on legal side

Clearly something went wrong from the first day, and NASDAQ immediately was suited in court by investors and traders: on Tuesday May 22, 2012, the US District Court of Manhattan started to inquire about what happened the previous days.

NASDAQ announced, on June 6, 2012, a “*mea culpa*” and the commitment to repay those who lost money on the day of the Facebook IPO due to technical problems and glitches.

NASDAQ planned to pay more than $13 million to and provide $26 million of trading discounts for investors involved.

Given that usually refunds for technical errors amount to maximum $3 million, NASDAQ's almost 40 million repayment was not enough to compensate all investors and big companies of their losses, since many them remained stuck with unsold shares even if they were trying to sell them or many bought them at higher price than the one established, and at the same time, was not the only gravy fact that characterized the Facebook stock market launch.

Indeed contemporaneously, more than 40 different lawsuits were carried by big companies and investors that bought Facebook shares on Friday May 18 against the Zuckerberg's corporation. The first lawsuit was filed in New York court on May 23 by a group of shareholders.

The reason behind this legal actions could be found in some Reuters articles about the main advisors.

Indeed, on Monday May 22 Reuters reported that the heads of the advisors, Morgan Stanley, received "privileged information" about Facebook earnings and did not share those information with the public of investors, but only with preferred clients.

Few hours later, Reuters published that also the other global coordinators, Goldman Sachs, JP Morgan and Bank of America Merrill Lynch were suspected of knowing "privileged information": all of them together with Morgan Stanley reduced their forecast about Facebook's earning of the same amount during the IPO roadshow, and this is clearly odd.

So, Facebook and its global coordinators were suited for not sharing critical information to the public just before the initial public offering.

At the beginning of June, Facebook asked to the Federal District Court in the Southern District of New York to consolidate all the lawsuits into one, since they regard almost the same charge. Facebook asked to blame NASDAQ for their technical mistakes which resulted in a less-then-expected performance.

Shareholders claimed instead that the revenues were revised downward by coordinators because Facebook did not share with the public the internal revenue projection due to the plan of a greater mobile usage, but only with Morgan Stanley and probably the other main advisors.

In 2015, the second US Circuit Court of Appeals, a federal court, stated that Facebook and its CEO Mark Zuckerberg cannot be suited by the shareholders for hiding future plans and prospects.

Instead the lawsuit against Morgan Stanley, charged by Wall Street's Financial Industry Regulatory Authority and Massachusetts Secretary of State William Galvin of improperly sharing information with preferred clients and not to the public ended in December 2012 with a fine of 5 million to the American financial corporation. The other advisors were instead not fined.

Financial following

In the days that followed the initial public offering, the value of the Facebook share dropped down progressively.
On August 20, 2012, the stock was priced $20: the collapse with respect to the IPO price was of 47%.
After the summer, the stock started slowly to increase its price: it took almost a year to reach back the price $38 decided for the initial public offering.
At December 20, 2013, the stock was priced $55.12 and joined the Standard&Poor 500 index.
At February 14, 2014, when Facebook company announced the acquisition of Whatsapp, the price reached $68.06.

Conclusion

The IPO of Facebook is one of the largest and most innovative IPOs all over the world, the price was set to the highest level of the price range, but some problems occurred, first the NASDAQ's technical problems on May 18, 2012 and second Morgan Stanley sharing privileged information with preferred clients.
Our intent was to analyse whether the law that regulates the prospectus was infallible, and we showed how in the Facebook IPO it was not applied in the correctly. There was not a total disclosure of the information regarding earnings. Of course, this was reflected in a huge share price downfall, so we can conclude that trying to elude prospectus and disclosure rule leads to fines and, moreover, is not well received by the market.

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